

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B03
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Date: May 18, 2009

LEGEND

X =

Trust 1 =

Trust 2 =

Closing
Agreement 1 =

Closing
Agreement 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated April 17, 2008, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code for an inadvertent invalid S corporation election.

FACTS

The information submitted states that X was incorporated under the laws of State on Date 1 and elected to be treated as an S corporation effective Date 2. As of Date 2, Trust 1 and Trust 2 (collectively the Trusts) were the sole shareholders of X. The trustees of the Trusts elected under § 1361(e)(3) to be electing small business trusts ("ESBTs") effective Date 2. However, during an examination of X's income tax returns for taxable years ending Date 3 and Date 4, it was discovered that the Trusts were foreign trusts. Therefore, the Trusts were ineligible S corporation shareholders and X's S corporation election was ineffective as of Date 2. Upon discovering that the Trusts were ineligible S corporation shareholders, the trustees and beneficiaries of the Trusts filed petitions in State court to modify an article in each of the Trusts' governing instruments so that the Trusts could be domestic trusts and eligible S corporation shareholders. On Date 5, the State court approved the judicial modification to each of the Trusts' governing instruments.

X represents that the circumstances resulting in its ineffective S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X represents that since Date 2, X and the Trusts have filed federal income tax returns consistent with X's S corporation election. X and its shareholders have agreed to make adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides, in part, that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2) provides that certain trusts, such as ESBTs, are permitted as shareholders of an S corporation. Section 1361(c)(2)(A) provides, in part, that § 1361(c)(2) shall not apply to any foreign trust.

Section 1361(e)(1)(A) provides that for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if - (i) the trust does not have as a beneficiary any person other than an individual, an estate, an organization described in § 170(c)(2), (3), (4), or (5), or an organization described in § 170(c)(1) that holds a contingent interest in the trust and is not a potential current beneficiary; (ii) no interest in the trust was acquired by purchase; and (iii) an election under § 1361(e) applies to the trust.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken (A) so that the corporation for which the election was made is a small business corporation or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the representations made and the information submitted, we conclude that X's S corporation election was ineffective as of Date 2. We also conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Accordingly, under § 1362(f), X will be treated as an S corporation from Date 2 and thereafter, provided that X's S corporation election is otherwise valid and is not otherwise terminated under § 1362(d).

This ruling is contingent on Trust 1 and Trust 2 complying with the terms of Closing Agreement 1 and Closing Agreement 2, respectively, and Trust 1 and Trust 2

paying the liabilities as determined in Closing Agreement 1 and Closing Agreement 2, respectively.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes or whether the Trusts are otherwise eligible to be ESBTs.

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

/s/

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes